Supreme Court, U.S.
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No. 08-719

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IN THE

Supreme Court of the United States

AMERICAN STEAMSHIP OWNERS MUTUAL PROTECTION AND INDEMNITY ASSOCIATION, INC.,

Petitioner,

—v.—

ASBESTOSIS CLAIMANTS,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Did the Second Circuit Court of Appeals, in reversing the decision of the district court which had affirmed the bankruptcy court, err in denying petitioner marine indemnity insurer ("American Club" or "Club") the proper full exercise of its judicially granted right of setoff under federal bankruptcy law, in conflict with relevant decisions of this Court?

2. In reaching its decision, did the Second Circuit, by—

(a) failing to state or apply any legal rule applicable to interpreting reorganization plan provisions,

(b) without analyzing or accurately stating bankruptcy plan § 4.05.07(a)(iv), wrongly asserting that it "authorized that any setoff owed by Prudential to an insurer be shared ratably among the Claimants and subtracted from each Claimant's individual recovery in much the same way as the deductibles . . . ," in such a way as to deny petitioner Club exercise of its adjudicated setoff right fully against the Trust when in fact subsection (iv) authorized nothing of the kind, but instead *mandated* that there be a ratable sharing among all affected claimants of *a claim against the offset amount*, i.e., the total amount previously offset by the Club; and

(c) in "quoting" that plan provision, excising certain words and adding others in

brackets, thus rewriting, distorting and concealing its actual language and true meaning, in such a way as to lend spurious credence to its wrong assertion of what plan § 4.05.07(a)(iv) "authorized",

so far depart from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's supervisory power?

RULE 14.1(b) STATEMENT

A list of all parties to the proceeding in the court whose judgment is the subject of this petition is as follows:

Appellee and Petitioner: American Steamship Owners Mutual Protection & Indemnity Association, Inc., a non-profit, assessable mutual indemnity insurance association of shipowners, based in New York, New York.

Appellants and Respondents: Asbestosis Claimants, unnamed seamen who allegedly were employees of Debtor Prudential Lines, Inc. and are represented by the Maritime Asbestosis Legal Clinic of Detroit, Michigan.

RULE 29(6) STATEMENT

American Steamship Owners Mutual Protection and Indemnity Association, Inc., a private non-governmental party, certifies that the following are corporate parents of said party, and any publicly held corporation that owns 10% or more of its stock: NONE

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(B) WITHOUT ANALYZING OR ACCURATELY STATING REORGANIZATION PLAN §4.05.07(a)(iv), WRONGLY ASSERTED THAT IT "AUTHORIZED THAT ANY SETOFF OWED BY PRUDENTIAL TO AN INSURER BE SHARED RATABLY AMONG THE CLAIMANTS AND SUBTRACTED FROM EACH CLAIMANT'S INDIVIDUAL RECOVERY IN MUCH THE SAME WAY AS DEDUCTIBLES . . . ." IN SUCH A WAY AS TO DENY THE CLUB EXERCISE OF ITS ADJUDICATED SETOFF RIGHT FULLY AGAINST THE TRUST, WHEN IN FACT THAT SUBSECTION (iv) AUTHORIZED NOTHING OF THE KIND BUT INSTEAD MANDATED THAT THERE BE A RATABLE SHARING AMONG ALL AFFECTED CLAIMANTS OF A CLAIM AGAINST THE OFFSET AMOUNT, I.E., THE TOTAL

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(C) IN "QUOTING" THAT PLAN PROVISION, EXCISED CERTAIN WORDS AND ADDED OTHERS IN BRACKETS, THEREBY REWRITING, DISTORTING AND CONCEALING ITS ACTUAL LANGUAGE AND TRUE MEANING, MISLEADINGLY LENDING SPURIOUS CREDENCE TO ITS WRONG ASSERTION OF WHAT PLAN 4.05.07(a)(iv) "AUTHORIZED"..... 20

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The Second Circuit reversed the Memorandum and Order of the United States District Court for the Southern District of New York decided on September 21, 2005, reported at 2005 U.S. Dist. LEXIS 20657 (S.D.N.Y. 2005) (App. B, 24a - 31a), which had affirmed the Memorandum Decision and Order of the United States Bankruptcy Court for the Southern District of New York dated January 19, 2004 [*sic*, 2005], not reported (App. C, 32a - 55a), denying a joint motion of Prudential Lines, Inc., ("PLI") Disbursement Trustee ("Trustee") and the Maritime Asbestosis Legal Clinic ("MALC"), on behalf of the Asbestosis Claimants, in PLI's Chapter 11 bankruptcy case. The joint motion sought approval of a proposal for payment of claims which Second Circuit has referred to as the "Proposed Payment Structure" ("PPS") (App. A, 3a, and which is described in App. A, 7a-9a).

STATEMENT OF JURISDICTION

This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

The Second Circuit's opinion was rendered on June 19, 2008. A timely petition for panel rehearing and petition for rehearing *en banc*, filed on July 7, 2008, was denied on September 2, 2008, without opinion. (App. D, 56a-57a).

STATUTORY PROVISION INVOLVED

This case involves 11 U.S.C. § 553, which provides in relevant part:

§ Setoff.

> (a) Except as otherwise provided in this section and in sections 362 and 363 of this title, this title does not affect any right of a creditor to offset a mutual debt owing by such creditor to the debtor that arose before the commencement of the case under this title against a claim of such creditor against the debtor that arose before the commencement of the case, except to the extent that—
>
> [Exceptions omitted as inapplicable.]

STATEMENT OF THE CASE

PLI or a predecessor was the owner of American flag merchant ships for many years. American Club annually issued assessable protection and indemnity insurance ("P&I") policies to PLI

from 1940 through 1970 and from 1975 through early 1986. PLI belonged to another P&I club from 1971 through 1974. As material here, the policies provided:

> [American Club] . . . DOES INSURE ____ (Herein called collectively the Assured) . . . IN THE INSURED SUM OF ____ DOLLARS [for a specific year] against the risks and subject to the terms and conditions hereunder set forth in respect of the named vessel . . .
>
> THE [AMERICAN CLUB] AGREES TO INDEMNIFY THE ASSURED AGAINST ANY LOSS, DAMAGE OR EXPENSE WHICH THE ASSURED SHALL BECOME LIABLE TO PAY AND SHALL PAY BY REASON OF THE FACT THAT THE ASSURED IS THE OWNER . . . OF THE INSURED VESSEL AND WHICH SHALL RESULT FROM THE FOLLOWING LIABILITIES, . . . :
>
> [Liability for loss of life, personal injury, and illness, as well as liability for cargo loss or damage. The claims were subject to deductibles in various amounts.][1]

Thus the Club's obligation to indemnify for covered claims is predicated on two basic contractual requirements: (1) that the assured is "liable

[1] This sample is adapted and abbreviated from the sample used by the bankruptcy court in *In re Prudential Lines, Inc.*, 148 B.R. 730, 736-37, n.3 (Bkrtcy. S.D.N.Y. 1992) (App. H, 124a, at 130a), hereinafter "*Prudential I*". A sample assessable insurance policy issued by the American Club is included in the Appendices hereto. (App. L, 311a-345a).

to pay . . . by reason of the fact that . . . [it] is the owner of the insured vessel . . ." (the "liable to pay" requirement) and (2) that it "shall pay" the underlying claim (the "pay first" requirement).

In late 1986 creditors filed an involuntary petition against PLI under Bankruptcy Code Chapter 11, and on November 4, 1986, PLI filed consent to entry of an Order for Relief. A modified plan of reorganization ("Plan") (App. F, 60a-85a) was confirmed on October 4, 1990. Among other things, the Plan provided for reorganization funding, established the PLI Disbursement Trust ("Trust") and authorized it to "attempt" to liquidate claims and to enforce the Trust's interests under PLI's insurance policies.

Under the Plan, the Trust was provided with funds of only $500,000 made up of "Insurance Preservation and Claims Liquidation Funds" of $200,000 (Plan, App. F. at 65a) plus "Liman Funds" of $300,000. (App. F. at 65a) The Trust also received a "Litigation Funding Commitment" of possible additional funds (App. F. at 65a, see also the definition of "Available Cash", 61a) which funds apparently never materialized as today the Trust's total assets are less than $230,000.[2]

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[2] The American Club respectfully asks the Court to take judicial notice of the latest financial report submitted by the PLI Trustee available in PACER, 86-11773, United States Bankruptcy Court, Southern District of New York, filed on October 21, 2008, Docket No. 1287. The Trust has total assets of less than $230,000 including a "Liman" fund of $100,000 and the Trust has debts of over $575,000. According to the Trust's financial reports, the Liman fund is the only Trust asset which is unencumbered. Thus the only

Meanwhile the Trust faced "Deferred Priority Claims" (App. F. at 64a), "Deferred Administrative Claims", including the Trustee's annual salary of $107,000 (Supplemental Disclosure Statement, App. G at 98a, 106a, 111a), as well as substantial claims by the American Club for unpaid premiums and assessments. (App. G at 118a).

The Plan is lengthy and, as discussed in detail *infra*, Point II, included a specific provision with respect to ratable sharing among affected claimants of a claim against the total offset amount which the Club might obtain against indemnification claims the Trustee might present to the Club.

More broadly, the Plan included a lengthy section, 4.05.07 (App. F, 71a - 81a), entitled *Treatment of Certain Claimants*, which among other things provided that the Trustee "succeed to all insurance rights of PLI," . . . "*attempt* to secure . . . [such] insurance rights", including "steps as specified . reasonably *intended* to obtain the benefits of insurance . . . In particular . . . and *subject to the availability of funds for such purpose* (App. F at 73a)[3] and satisfactory assurances and documentation . . . Trustee is authorized to enter into arrangements . . ." whereby he ". . .

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funds available to pay claims total $100,000. Apparently, over the last 18 years since 1990, the Plan's provisions for litigation funding have not succeeded.

[3] In view of the Trust's dearth of funds, this is an important requirement which the PPS was designed to evade. Second Circuit does not mention it. More generally, the emphasized words and phrases indicate that the Plan was in large part a matter of "attempt" and "inten[tion]" and "subject to availability of funds," so was not foreordained to success.

pays the Allowed Insurance Claim in full in cash", the claimant repays "... the Deductible Claim [essentially, the amount of the deductible] and the Club ... reimburses the [Trustee] in cash for the full amount of the Excess Claim [i.e., in excess of the deductible] and the claimant is given an Allowed Claim in Class 5C in the amount of the Deductible Claim." (*See* Plan § 4.05.07(a)(i) (App. F, at 71a-74a), emphasis added.)

The Plan also limits the Trustee's potential liability to pay any claims. Article IV entitled *Treatment of Classes*, provides, as relevant:

> 4.05.03 *Class 5C.* Each holder of a Class 5C Claim, subject to §§ 5.01, 5.15, and 6.01c of this Plan, *shall* receive:
>
> * * *
>
> ii) *after payment in full of all Deferred Administrative Claims and all Deferred Priority Claims*, its Pro Rata share of a percentage (calculated in accordance with and subject to § 4.05.04(b) of the Plan) of any further distributions of Available Cash of the PLI Disbursement Trust.
>
> In addition, *subject to possible defenses to payment Clubs or other insurers may have*[4], holders of Insured Claims in Class 5C, including holders of Allowed Late-

[4] The qualifiers, "subject to possible defenses to payment Clubs ... may have ...", "may be" and "attempt", emphasize that the Club's defenses were preserved in the Plan and that the Plan was not certain of success.

> Filed Asbestos Claims, *may be* entitled to payment in cash of Excess Claims, directly or indirectly, from Clubs or other insurers. As set forth in § 4.05.07(a) of the Plan, $200,000 shall be set aside by the PLI Disbursement Trust in order to *attempt* to preserve insurance rights and to provide funds for the liquidation of Personal Injury Claims and Cargo Damage Claims and an additional $300,000 shall be set aside in Liman funds. . . .

Plan, App. F, 69a-70a (emphasis added). (Plan § 4.05.07(a)(ii) makes the same point (App. F at 74a-76a) and contains similar qualifiers.)

Thus, the Plan provided that, whatever the Trust's underlying theoretical liability for any claim, its "liability to pay" claims is limited to its "Available Cash" (defined in App. F, 61a) after payment of Deferred Administrative and Priority Claims, and no Claimant is entitled to receive more (nor is the Trust liable to pay more) than a Pro Rata share of that Available Cash. In any event, the Club's stipulated setoff of $1,270,980[5] far exceeds the Trust's present Available Cash (even *before* deducting payment of deferred Administrative Claims). Accordingly, on that score alone, as discussed further in Point I below, the Club can have no contractual obligation to indemnify the Trustee with cash in any amount.

In December 1990 the Trustee commenced an adversary proceeding against the Club seeking judgment on various aspects of the P&I policies.

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[5] In 1992, the amount of the Club's setoff was stipulated to be $1,270,980. *Prudential I*, 148 B.R. at 754. (App. H, 176a).

Asbestosis Claimants were permitted to intervene, and the Club also moved for judgment on its asserted setoff rights. On December 10, 1992, the bankruptcy court, in *Prudential I*, after a thorough discussion, held that "the Plan does not alter Club's contractual obligations as they exist under the P&I policies and applicable law." *Id.* at 748, App. H, 161a. The bankruptcy court also upheld the American Club's setoff rights, stating:

> 5. American Club may offset unpaid premiums and assessments against sums payable to Trustee under the provisions of triggered P&I policies. As stipulated by the parties, the amount of the setoff is $1,270,980. If American Club exercises this right to setoff, the Trust is entitled to the contractual benefits of the 1979, 1983, 1984, and 1985 policies.
>
> Partial summary judgment regarding this issue is granted in favor of American Club. American Club's motion for relief from the automatic stay will be set for a hearing, if necessary.

Id. at 754, App. H, 176a, and *see* the ensuing Judgment of the bankruptcy court formally granting the American Club's setoff right in the amount of $1,270,980. (App. I, 179a) None of the foregoing holdings or the judgment were appealed, and they are *res judicata*.

In March 2004, twelve years after *Prudential I*, and after further litigation concerning the rights and obligations of the parties[6] under (a) the

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[6] See, e.g., *In re Prudential Lines, Inc.*, 170 B.R. 222 (S.D.N.Y. 1994) (*Prudential II*) (App J, 181a) and *In re Pru-*

insurance policies, (b) the Plan, and (c) New York law, the Trust and MALC filed a joint motion seeking an Order from the Bankruptcy Court purportedly "to enforce" the Club's setoff rights (but actually calculated to cripple them) by seeking approval of what is now called the Proposed Payment Structure ("PPS").

The bankruptcy court's jurisdiction was predicated on 28 U.S.C. § 1334(b), the Standing Order of the United States District Court for the Southern District of New York, referring bankruptcy cases to the Bankruptcy Court, 148 B.R. 730, 734-35 n.1 (App. H, 125a) and the terms of the Plan. (App. C, 83a).

According to the Second Circuit (App. A, 7a-9a), under the PPS, essentially the Trustee would (1) pay each Allowed Claim (presumably in an amount agreed by the Club or ordered by the court) (2) each claimant would repay to the Trustee both the relevant deductible amount and his "pro-rata share" of the Club's [anticipated] setoff; (3) the Trustee would make an indemnity claim against the Club for his net payment [i.e., minus the deductible and the claimant's "ratable share of the setoff"] and the Club would be required to indemnify the Trustee for the net amount he paid. Dividing the Club's estimated total $1,200,000 setoff right by an estimated 10,000 claimants, the Second Circuit "estimated" the "pro-rata share" of the setoff at an average of about $120.[7] (App. A, 9a, 16a) Thus, that court

dential Lines, Inc., 158 F.2d 65 (2d Cir. 1998) (*Prudential IV*) (App. K, 242a).

[7] This mention of an estimated average pro-rata (or ratable) share of the total setoff right sidesteps the fact that,

would limit use of the Club's setoff to a miniscule sum of about $120 against each claim, rather than the way the Club is legally entitled to use it, (dollar for dollar, up to the $1,270,980 total), whereby the Club would pay nothing unless its full setoff right was exhausted. The improper PPS process would thus be repeated for each claim. With its funds repeatedly replenished, the Trustee would repeat the procedure until all claims were paid, a scheme in which the Trust has no financial interest, as it would merely funnel the Club's money to the claimants - a scheme devised solely to avoid the effect the Club's rightful setoff. As recognized by both the bankruptcy court and district court, the PPS would effectively grant the Asbestosis Claimants a direct action against the Club, an action prohibited by New York law. (App. C, 44a; App. B, 27a).

The obvious reason for devising and proposing the "PPS" was that under the Plan, Trustee had, and still has, severely limited Available Cash (now $100,000) with which to pay claims, so that if the Club were to utilize its setoff in the dollar for dollar manner to which it is legally entitled, the Trustee's $100,000 of Available Cash would be exhausted by the first $100,000 of claim payment/setoff application, and the Trustee would have no more funds to pay claims. Since the indemnity policies required that PLI (or, here, its successor Trustee) pay its liabilities *before* being entitled to indemnity, the Trustee would be neither liable to pay nor able to pay any claims

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as Point II discusses in detail, the Plan requires a ratable sharing of "a claim against the offset . . . amount," *not* the total offset right. Second Circuit never quotes the material provision, § 4.05.07(a)(iv), accurately.

aggregating more than the first $100,000 and thus could never trigger the Club's obligation to indemnify.[8] The PPS is no more than an improper device to enable the Trustee to obtain infusions of cash from the Club to which it is not legally entitled and pay, at the Club's sole expense, claims which the Trustee otherwise would be neither liable to pay, nor able to pay.

The Club opposed the joint motion, and the bankruptcy court denied it on January 19, 2005 by the unreported Memorandum Decision and Order. (App. C) Only MALC (not the Trustee) appealed to the District Court, which on September 21, 2005, affirmed the bankruptcy court decision and order. (App. B) This time both MALC and the Trustee appealed to the Second Circuit, which properly dismissed the Trustee's appeal due to his failure to appeal to the district court from the bankruptcy court decision. (App. M) Nevertheless, the Second Circuit thereafter heard and decided MALC's appeal, rendering its decision (App. A), reversing and remanding to the district court. After denying the Club's peti-

[8] The insurance policy and the Plan combined give the Club the right to refuse to indemnify for any claim exceeding the claimant's Pro Rata share of Available Cash ($100,000), since that is all the Trust is "liable to pay." However, even if it were wrongly held that the Trustee is "liable to pay" the full amount of each claim, without regard to Available Cash, since Trustee has so limited an amount of Available Cash, which the Club's offset amount greatly exceeds, Available Cash would be exhausted long before the Club would be obligated to indemnify, and then the Trust would be unable to pay any more claims. The Second Circuit in *Prudential IV*, 158 F.3d at 74-75, (App. K, 263a) termed this as "simply one consequence of purchasing a marine policy of indemnity rather than a liability policy."

tion for rehearing, the Second Circuit issued its Judgment on September 15, 2008. (App. E).

Second Circuit states its reasons for denying the Club the full use of its setoff (App. A, 14a-23a) with a deeply disturbing coda in n.6 at 22a. Much of what it wrote is speculative, wrong[9], and obviously irrelevant to its decision in this case, but at page 17a it distills its reasons into three:

> . . . The Insurer asks us to interpret the bankruptcy court's decision [*Prudential I*, 148 B.R. 730, App. H, 124a] granting a broader opportunity to setoff in a manner which would be unreasonable for three different reasons. *First, it asks that we construe a decision, which on its face simply granted it a broad opportunity for setoff, as effectively absolving it from any obligation to make payments under the policies. Second, it asks us to interpret the decision as granting exactly the relief the bankruptcy court, in the same decision, refused to grant. Finally, it asks us to interpret the bankruptcy court's decision in a manner contradictory to the Bankruptcy Plan, which expressly envisioned proration of the setoff.* We believe this is not a reasonable interpretation of

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[9] For example, there is no valid comparison between this case and *Liman v. American Steamship Owners Mutual Protection and Indemnity Association, Inc.*, 299 F. Supp. 106 (S.D.N.Y. 1969); aff'd 417 F.2d 627 (2d Cir. 1969) (per curiam), cert. den. 397 U.S. 936 (1970) as setoff was not an issue in that case. Second Circuit's comparisons at App. A, 18a-20a are misplaced.

> the bankruptcy court's silence as to how the setoff would be allocated . . .

App. A, 17a (emphasis added).

The first two reasons are readily refuted. First, the bankruptcy court's decision in *Prudential I* did not "simply grant [ ] . . . a broad opportunity for setoff". As stated above, the bankruptcy court explicitly granted the Club a setoff in the amount of $1,270,980, without any suggestion that Plan § 4.05.07(a)(iv) "authorized" or even "envisioned" piecemeal proration of the Club's setoff and without any reference to the potential consequences of the setoff which, as it has turned out, depend on the separate issue of the effectiveness of the Plan's provisions for providing funds for the Trust. In short, the bankruptcy court granted the requested setoff after careful legal analysis properly applying the law[10] without being improperly result-oriented. There is no legitimate reason whatever to raise a question as to "the bankruptcy court's silence as to how the setoff would be allocated", *supra*. Clearly, absent any contrary indication (and there is none), the setoff was not to be "allocated" at all, but applied fully against the Trustee's indemnity claims on the Club in the usual way as endorsed by decisions of this Court. In fact, expressly applying New York law, the bankruptcy court in *Prudential I* quoted from the New York statute providing the right

> . . . to setoff and apply against any indebtedness, whether matured or unmatured, of such creditor to such debtor,

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[10] See *Prudential I*, 148 B.R. at 750-52 (App. H, 166a-173a).

> *any amount owing* from such debtor to such creditor . . .

148 B.R. at 751 (App. H, 169a), (court's emphasis). This language fully confirms the logical and reasonable understanding that the setoff was to be exercised in the usual way and its exercise should *not* be "allocated". Contrary to Second Circuit's assertions (App. A, 21a), the Club cannot reasonably be charged with "failure" to appeal the bankruptcy court's judgment, as that judgment was correct and favored the Club.

Second Circuit's second "reason" is that the Club asked it "to interpret the [bankruptcy court's] decision as granting exactly the relief [it], in the same decision, refused to grant." This is patently incorrect. The Club had requested two alternative forms of relief—(1) setoff, which, as discussed above, the bankruptcy court granted, 148 B.R. at 750-52) (App. H, 166a-172a) and (2) that the Trustee assume all the policies under the *cum onere* doctrine, which the court discussed and denied at 148 B.R. at 752-753 (App. H, 172a-173a). The denial of the second, like the grant of the first, was made on the basis of the court's legal analysis and was not improperly result-oriented. Each of the two questions involved separate issues and was decided independently. Again, the fact that, sixteen years later, the reorganization plan has failed to generate more funds than it has is a separate circumstance irrelevant to the decisions on those issues. It was a possibility inherent in the Plan that such a circumstance might come to pass inasmuch as successful execution of its relevant provisions

was expressly "subject to the availability of funds", as discussed *supra*.

Second Circuit's third reason for denying the setoff is that the Club "asks us to interpret the bankruptcy court's decision in a manner contradictory to the Bankruptcy Plan, which expressly envisioned proration of the setoff." (App. A, 17a) That brings us to consideration of Second Circuit's own manner of "interpreting" (actually improperly rewriting) the Plan which is relevant and paramount to its denial of the Club's proper exercise of its setoff right and thus merits consideration as a related but additional ground for granting this petition, as will be set forth in Point II below.

REASONS FOR GRANTING THE PETITION

I. REVIEW IS WARRANTED BECAUSE, IN APPROVING THE PPS, THE SECOND CIRCUIT UNJUSTIFIABLY DENIED THE CLUB ITS RIGHT TO FULL EXERCISE OF ITS SETOFF UNDER FEDERAL BANKRUPTCY LAW, IN CONFLICT WITH RELEVANT DECISIONS OF THIS COURT.

The PPS affords the Club only a limited application of its setoff right, i.e., for each claim paid by the Trustee for which he seeks indemnity, the Club would be restricted to getting the benefit (indirectly) of only a tiny "pro rata" part of its setoff, estimated by the Second Circuit at about $120. That is neither "authorized" nor "envisioned" by the Plan. Rather, it is contrary to the

Plan, the Bankruptcy Code and the law stated by this Court on more than one occasion.

In *Citizens Bank of Maryland v. Strumpf*, 516 U.S. 16 (1995), this Court stated the law as to setoff in the bankruptcy context:

> The right of setoff (also called "off-set") allows entities that owe each other money to apply their mutual debts against each other, thereby avoiding "the absurdity of making A pay B when B owes A." Studley v. Boylston Nat. Bank, 229 U.S. 523, 528. Although no federal right of setoff is created by the Bankruptcy Code, 11 U.S.C. § 553(a) provides that, with certain exceptions, whatever right of setoff otherwise exists is preserved in bankruptcy . . .

Id. at 18. The Second Circuit decision causes the precise absurdity this Court refers to, making the Club pay the Trust while the Trust still owes the Club an amount it can never pay. In the case cited, *supra*, *Studley v. Boylston Nat. Bank*, 229 U.S. 523 (1913), this Court had further explicated the right of setoff:

> . . . in strictness, a set-off is a counterclaim which the defendant may interpose by way of cross-action against the plaintiff. But, broadly speaking, *it represents the right which one party has against another to use his claim in full or partial satisfaction of what he owes to the other.*

Id. at 528 (emphasis added).

The law of New York (the state whose setoff law is here preserved by 11 U.S.C. § 553(a)) is in full accord with this Court's view. In *Matter of Midland Insurance Co.*, 79 N.Y.2d 253, 590 N.E.2d 1186, 582 N.Y.S.2d 58 (1992), in the context of a dispute between an insolvent insurer and its reinsurer, the New York Court of Appeals allowed the reinsurer to offset all premiums due it from the primary insured and pay out only the *balance* remaining, stating:

> Our statutes also permit insurers to net their respective preliquidation debts. Thus, the insurance law provides "[i]n all cases of mutual debts or mutual credits between the insurer and another person in connection with any action or proceeding [in rehabilitation or liquidation], such credits and debts shall be set off *and the balance only shall be allowed or paid.*

Id. at 258-59.

The proper meaning of setoff is also described in *Collier on Bankruptcy*, 15th Ed. Rev. ¶ 1100.08[4]:

> The Bankruptcy Code preserves a creditor's right to set off mutual obligations with the debtor. Thus, a creditor who owes money to the debtor may offset its indebtedness against the debtor's obligation and, in effect, recover the amount owed by the debtor through the set off process. For example, if a creditor owed a debtor $10,000 and the debtor owed the creditor $10,000 from another transac-

> tion, the creditor could set off the two debts and neither pay nor receive any money. Without a right of set off, the creditor would be required to pay $10,000 (the amount owed to the debtor) to the Trustee in bankruptcy and would have a general claim in the bankruptcy for the $10,000 that the debtor owed to the creditor. Since dividends in bankruptcy proceedings are normally considerably less than 100%, the creditor would lose money. Thus, by enabling the creditor to collect its claim through set off, the Code prefers that creditor over others, but the administrative efficiency and historical equitable right of mutual debtors to set off their claims was apparently seen as overriding any ill effect. (Citations omitted.)

If it be thought that granting the Club full exercise of its setoff would be "unjust" to Claimants, that type of consideration has been properly rejected by the Second Circuit itself. *See, e.g., In Re Applied Logic Corp.*, 576 F.2d 952, 957 (2d Cir. 1978):

> The rule allowing setoff, both before and after bankruptcy, is not one the Courts are free to ignore when they think application would be unjust.

See also n. 8 supra, quoting *Prudential IV.*

Unquestionably, the Club is legally entitled to use its court-ordered right of setoff of $1,270,980 in *full* satisfaction of whatever it might owe the Trustee *before* paying any amount to the Trustee. That means that the Club may exercise its right

of setoff up to its full amount "against sums payable to the Trust under triggered P&I policies", *see*, *Prudential I* at 754 (App. H, 166a-172a), discussed above.

II. REVIEW IS ALSO WARRANTED BECAUSE THE SECOND CIRCUIT—

(A) FAILED TO STATE OR APPLY ANY LEGAL RULE APPLICABLE TO INTERPRETING REORGANIZATION PLAN PROVISIONS,

(B) WITHOUT ANALYZING OR ACCURATELY STATING REORGANIZATION PLAN § 4.05.07(a)(iv), WRONGLY ASSERTED THAT IT "AUTHORIZED THAT ANY SETOFF OWED BY PRUDENTIAL TO AN INSURER BE SHARED RATABLY AMONG THE CLAIMANTS AND SUBTRACTED FROM EACH CLAIMANT'S INDIVIDUAL RECOVERY IN MUCH THE SAME WAY AS DEDUCTIBLES . . . ." IN SUCH A WAY AS TO DENY THE CLUB EXERCISE OF ITS ADJUDICATED SETOFF RIGHT FULLY AGAINST THE TRUST, WHEN IN FACT THAT SUBSECTION (iv) AUTHORIZED NOTHING OF THE KIND BUT INSTEAD MANDATED THAT THERE BE A RATABLE SHARING AMONG ALL AFFECTED CLAIMANTS OF A CLAIM AGAINST THE OFFSET AMOUNT, I.E., THE

TOTAL AMOUNT PREVIOUSLY OFFSET BY THE CLUB, AND

(C) IN "QUOTING" THAT PLAN PROVISION, EXCISED CERTAIN WORDS AND ADDED OTHERS IN BRACKETS, THEREBY REWRITING, DISTORTING AND CONCEALING ITS ACTUAL LANGUAGE AND TRUE MEANING, MISLEADINGLY LENDING SPURIOUS CREDENCE TO ITS WRONG ASSERTION OF WHAT PLAN 4.05.07(a)(iv) "AUTHORIZED",

ALL OF WHICH SO FAR DEPARTED FROM THE ACCEPTED AND USUAL COURSE OF JUDICIAL PROCEEDINGS AS TO CALL FOR AN EXERCISE OF THIS COURT'S SUPERVISORY POWER.

The Second Circuit failed to state any legal rule applicable to interpretation of a reorganization plan, which is similar to a contract and generally interpreted under contract law principles of the state where the reorganization plan was confirmed. *See, C.F. Brookside, Ltd. v. Skyview Memorial Law Cemetery (In re Affordable Hous. Dev. Corp.)*, 175 B.R. 324, 329 (B.A.P. 9th Cir. 1994) cited by Bankruptcy Judge Gonzalez in the bankruptcy court decision below. (App. C, 47a) Judge Gonzalez also referred to Morlee Sales Corp. v. Manufacturers Tr. Co., 9 N.Y.2d 16 (N.Y. 1961) for two principles applicable here, but disregarded by Second Circuit:

> It is axiomatic that a contract is to be interpreted so as to give effect to the

> intention of the parties as expressed in the unequivocal language employed . . . The courts may not by construction add or excise terms, nor distort the meaning of those used and thereby "make a new contract for the parties under the guise of interpreting the writing."

Id. at 19, App. C, 47a (citations omitted). The bankruptcy court, viewing the Plan as a whole, held that that § 4.05.07(a)(iv) was "not ambiguous" and did "not require American Club to make any payments [to the Trust] prior to the satisfaction of its set-off right." (App. C, 49a)

The Second Circuit, without any analysis or explanation, wrongly states that Reorganization Plan § 4.05.07(a)(iv)

> . . . *authorized that any setoff owed by Prudential to an insurer be shared ratably among the Claimants and subtracted from each Claimant's individual recovery in much the same way as the deductibles (that is, each Claimant, out of the funds received in payment of his claims, would return to the Trustee his ratable share of the setoff and receive in exchange a claim for that amount*).

(App. A, 5a, emphasis added to indicate that part of the quotation from the Second Circuit's decision is inconsistent with and contrary to the actual language and meaning of subsection (iv), i.e., all of it.)

In fact § 4.05.07(a)(iv) does not so "authorize" nor is it reasonable to assert that it does. Sub-

section 4.05.07(a)(iv) actually states in material part:

> . . . To the extent there shall be a determination that amounts are due and owing from PLI to a Club or insurer which the Club or insurer may offset or recoup against amounts due to PLI, Reorganized PLI, the PLI Disbursement Trust or any claimant in respect of Excess Claims (and to the extent such amounts are not otherwise offset pursuant to § 4.05.07(a)(i) of the Plan or otherwise), and *to the extent possible*, each holder of an affected Allowed Insured Claim *shall share ratably* (with all other holders of affected Allowed Insured Claims *based on the allowed amount of each such Insured Claim*) (a) *a claim against the offset or recouped amount* and shall receive in distribution therefor an Allowed Claim in Class 5C and (b) a claim in respect of any remaining insurance rights relating to such affected Allowed Insured Claims and shall receive in distribution therefor, *to the extent recovered*,[11] cash from the insurer or Club equal to such holder's ratable share.

Plan, § 4.05.07(a)(iv), App. F, 77a-78a (emphasis added).

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[11] The qualifiers "to the extent possible" and "to the extent recovered" along with the qualifiers in other Plan sections clearly (a) reflect an uncertainty of result and (b) preserve the American Club's defenses, as expressly held by the bankruptcy court. (App. C, 49a)

A comparison of Second Circuit's assertion as to what § 4.05.07(a)(iv) supposedly "authorized" with the actual language of the subsection makes it clear that, far from "authorizing" the procedure the Second Circuit describes, the subsection, using the mandatory "shall", actually *requires*, focusing on the material part, that:

> . . . *to the extent possible*, each holder of an affected Allowed Insured Claim *shall share ratably* (with all other holders of affected Allowed insured Claims based on the allowed amount of each such Insured Claim) (a) *a claim against the offset or recouped amount* . . . (emphasis added)

§ 4.05.07(a)(iv), *supra*. This mandatory language makes it clear that the holders of claims *shall* share ratably among themselves a *claim* (singular) *against the offset or recouped amount*, also singular and, by clear use of the past tense in the adjectival "offset or recouped" (both modifying "amount") necessarily meaning the amount *already* offset or recouped vis-à-vis the Trust's claim(s) on the Club; and use of the definite article, "the", signifies that a particular single amount is meant, which logically can only mean the total amount offset.[12] Moreover, the qualifiers "to the extent possible" and "to the extent recovered" make it clear that the Plan's drafters, the Committee of Unsecured Creditors and others (App. F, 60a), were fully aware that carrying out

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[12] Quite apart from a verbal and grammatical analysis, calculating piecemeal ratable shares of successive offsets "owed by Prudential" before the offset amount is known and thereafter calculating the overall ratable shares would be an accounting nightmare, if it could be done at all.

this provision of the Plan might be impossible or possible only to a limited extent. It is clear that subsection (iv) actually provides only for a ratable sharing among affected claimants of a claim against *the* [previously] offset amount, *not* a ratable sharing of "any setoff owed by Prudential", as Second Circuit wrongly asserts. Its statement of what the subsection "authorized" is flatly contradicted by the actual subsection and effectively is a rewriting of that subsection. Indeed, Second Circuit's statement of what subsection (iv) "authorized" was obviously drawn in substance entirely from the PPS proposed by MALC and the Trustee, *not* the actual Plan § 4.05.07(a)(iv).

Additionally, it is plain that § 4.05.07(a)(iv), cannot be implemented as its language clearly requires without knowing (a) the total of the offset amount, (b) the amount of each Allowed Insured Claim and hence (c) the total amount of all such claims, because only by determining (a), (b) and (c) would it be possible to calculate each claimant's ratable share of a claim against *the* offset amount, as the subsection requires.

The PPS approved by Second Circuit clearly violates those requirements in that (a) it would *not* be applied to *the* single offset amount and (b) could *not* utilize a ratable share, the percentage of which would necessarily be based on the allowed amount of each claim divided by the total amount of all allowed claims. Instead, it would wrongly use a piecemeal system of successive payments and, Second Circuit suggests, some sort of an estimated "average" to supplant each affected claimant's ratable share of the offset amount. (App A, 9a, 16a) But such an estimated

"average" is simply not the "ratabl[e] share" mandated by § 4.05.07(a)(iv). Moreover, Second Circuit's assertion *supra* at p. 21 that subsection (iv) "authorized that any setoff *owed by Prudential* to an insurer be shared ratably among the claimants and subtracted from each Claimant's individual recovery in much the same way as deductibles . . ." is inconsistent with and contrary to the procedure specified and required by subsection (iv). As discussed above, subsection (iv) mandates a ratable sharing only of a (singular) claim against *the* offset amount (i.e., as explained above, surely the single total amount already offset).

The foregoing illustrates why the PPS differs from the actual procedure in subsection (iv). But the basic reality of the matter is that the "ratable share" provision of subsection (iv) mandates a procedure very different from the PPS and simply does not "authorize" the PPS, nor does any provision of the Plan. Finally, the actual subsection (iv) is fully consistent with the proper application of a setoff, whereas the PPS is not.

The Second Circuit Opinion never analyzes the actual language of § 4.05.07(a)(iv). Worse yet, when, at last, it "quotes" that section, it violates the most basic principle of contract interpretation by changing the phrase "(a) a claim against the offset or recouped amount" (see our quotation, *supra* at p. 22) to read ". . . (a) a claim against the offset [as represented by a claim against the Trust]" (App. A, 22a, n.6)—thus improperly rewriting that provision! Second Circuit's misquotation of the subsection has a dual effect. By excising the key words, "or recouped

amount", and substituting its invented bracketed phrase, "[as represented by a claim against the Trust], the court (1) conceals the actual language and true meaning of the subsection and (2) lends apparent (but spurious) credibility to its initial inaccurate assertion of what the subsection "authorized," at App. A, 5a, quoted *supra* at p. 21. In this connection, the omission of subsection (iv)'s actual language conceals the fact that the subsection actually refers to sharing ratably a claim against "the [single] offset ... amount" necessarily one previously offset (obviously by the Club against the Trust, as the Club's offset was only enforceable against the Trust), not a series of piecemeal setoffs "owed by Prudential to an insurer", and applied against the claimant, as the PPS would have it. And substituting the phrase ["as represented by a claim against the Trust"] suggests wrongly that the ratable sharing of the offset amount is to be determined or estimated before the setoff has even been applied, contrary to the subsection's actual requirements.

Second Circuit's decision is so constructed that one cannot discern simply by reading it that Second Circuit initially asserted that subsection (iv) "authorized" something it had not in fact authorized and thereafter "quoted" the subsection in such a way as to conceal its true meaning and make it seem consistent with the Court's initial assertion, at least to an unsuspecting reader. In short, the Second Circuit has improperly rewritten Plan § 4.05.07(a)(iv) and effectively concealed that fact.

Second Circuit thus grossly departed from the accepted and usual course of judicial proceedings so far, we respectfully submit, as to call for an exercise of this Court's supervisory power. That departure was the principal factor in Second Circuit's erroneous denial of the Club's right to proper full exercise of its setoff against the Trust, before paying any amount to the Trust.

CONCLUSION

As the Second Circuit's decision on setoff conflicts with this Court's decisions and its effective rewriting of the Plan and concealment thereof are glaring departures from the accepted and usual course of judicial proceedings calling for the exercise of this Court's supervisory power, Petitioner respectfully requests the issuance of a writ of certiorari to the United States Court of Appeals for the Second Circuit.

Respectfully submitted,

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